RSC Republican Study Committee

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Legislative Bulletin……………………………….…………October 26, 2005

Contents:

Summary of the Bills Under Consideration Today:

Total Number of New Government Programs: 0

Total Cost of Discretionary Authorizations: $0

Effect on Revenue: $0

Total Change in Mandatory Spending: See cost estimate below

Total New State & Local Government Mandates: 0

Total New Private Sector Mandates: Several

Number of *Bills* Without Committee Reports: 0

Number of *Reported* Bills that Don't Cite Specific Clauses of Constitutional Authority: 0

H.R. 1461 — Federal Housing Finance Reform Act (Baker)

Order of Business: The bill is scheduled to be considered on Wednesday, October 26th, subject to a structured rule (H.Res. 509) that makes in order nine amendments summarized below.

Background: The Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) are government-sponsored enterprises (GSEs) created to facilitate a *secondary* mortgage market. Under their charter, they exist to buy mortgages from lenders in the *primary* mortgage market and package them into securities for sale to investors on Wall Street. With the old loans off their books, lenders in the primary market can then make additional loans to consumers.

Currently, the GSEs are regulated by the Department of Housing and Urban Development s Office of Federal Housing Enterprise Oversight, commonly known as OFHEO.

However, Fannie Mae and Freddie Mac s charter came with significant government subsidies not enjoyed by their private sector competitors, including a $2.3 billion line of credit with the U.S. Treasury (i.e., borrowing at below market rates), an exemption from state, and local taxes, and an exemption from certain Securities and Exchange Commission (SEC) registration requirements (including fees as publicly traded companies). In addition, as a result of these government subsidies, Fannie Mae and Freddie Mac benefit from an *implicit* guarantee that the debt they issue is backed by the full-faith-and-credit of the U.S. Treasury, making GSE debt instruments almost as attractive to investors as government bonds.

Recent Accounting Failures: In 2003, Freddie Mac admitted that it had used improper accounting policies to create the appearance of steady earnings growth and issued a restatement of financial results. OFHEO imposed a $125 million fine and is pursuing civil actions against several former Freddie Mac executives. Similarly, in 2004, OFHEO issued a public report that was highly critical of accounting methods at Fannie Mae. OFHEO charged that Fannie Mae has not followed generally accepted accounting practices, allowing Fannie Mae to present investors with an artificial picture of steadily growing profits, and, in at least one case, to meet financial performance targets that triggered the payment of “cookie jar” bonuses to company executives.

In addition, Fannie Mae reported that it was unable to file a third-quarter earnings statement because its auditor refused to sign off on the accounting results. One month later, after finding similar inadequacies in Fannie Mae’s accounting policies and methodologies, the SEC directed Fannie Mae to restate all of its accounting results since 2001. Shortly after this announcement, both Fannie Mae’s CEO and CFO resigned their posts. Such recent accounting failures have led many lawmakers and commentators to conclude that current regulatory framework of OFHEO governing the GSEs is inadequate. H.R. 1461 is an attempt to provide a stronger such regulatory framework.

Possible Conservative Concerns: Conservatives might be concerned with the overall lack of reform including:

- the increased conforming loan limits in **“high cost areas”** (see below)
- the lack of a **“bright line”** between primary and secondary business activity to prohibit the GSEs from leveraging their government benefits into other activities outside their charter (see below)
- the **Affordable Housing Fund** (see below)
- the **one year delay** before the new regulator is up and running (see below)
- the **new duty to “minimize the cost of housing finance”** (see below)

In addition, H.R. 1461 lacks a major reform element of the Senate-reported GSE reform bill (S. 190) – **portfolio limits**. Under current law, the GSEs repackage the mortgages they buy from primary lenders and as mortgage-backed securities (MBS) for sale to investors or held them on their portfolio. The sale of MBS provides capital for the GSEs to purchase additional mortgages rather than issue debt. Over the past decade, the GSEs have begun to increasingly repurchases MBS and hold it in their portfolio, forcing them to issue debt (backed by an implicit guarantee by the federal government) to purchase new mortgages.

Accordingly, the GSEs have built up large portfolios (at a combined value of $1.5 trillion, with $1.7 trillion in combined debt) which are mortgage-related and thus sensitive to interest rate increases and decreases. S. 190 would limit the GSEs portfolios, prohibiting the GSEs from repurchasing their MBS and holding mortgages on their portfolios. H.R. 1461 authorizes the regulator to review the portfolios but not reduce them (see below).

For more information on the need for portfolio limits, please visit the Senate Republican Policy Committee at: http://rpc.senate.gov/_files/Jun0705FFportfolioJT.pdf

Summary by Title:

Title I: Reform of Regulation of Enterprises and Federal Home Loan Banks

- **Definitions:** Defines a regulated entity as Fannie Mae, Freddie Mac, their affiliates, and each Federal Home Loan Bank. An affiliate include: directors, employees, officers, controlling stockholders, agents, shareholders, consultants, independent contractors (an accountant or an attorney), or any nonprofit entity "that receives its principal funding, on an ongoing basis, from any regulated entity."

Subtitle A: Improvement of Safety and Soundness

- **New Regulator**: Establishes the Federal Housing Finance Agency (FHFA) to regulate Fannie Mae, Freddie Mac, and the Federal Home Loan Banks (FHLBs) and replace OFHEO. The new independent agency will be headed by a Director, appointed by the President and confirmed by the Senate, for a term of five years. In addition, the bill requires the appointment of three deputy directors; one to supervise the GSEs, one to oversee the FHLBs, and the other to focus on the affordable housing mission of the GSEs (see below).

- **Director Duties:** Requires the regulator to ensure that regulated entities operate in a "safe and sound manner," maintain adequate capital and internal controls, and contribute to "liquid, efficient, competitive, and resilient national housing finance markets **that minimize the cost of housing finance.**" (Some conservatives may argue that this new duty will inhibit the new regulator from restraining the GSEs and lend support to their arguments when they later attempt to engage in new business activities.)

  In fulfilling these principal duties, the regulator is instructed to propound regulations setting forth standards regarding the:

  (1) adequacy of internal controls and information systems;
  (2) independence and adequacy of internal audit systems;
  (3) management of interest rate and market risk;
  (4) adequacy and maintenance of liquidity and reserves;
  (5) management of asset and investment portfolio growth;
  (6) investments and acquisitions by an enterprise to ensure they are consistent with current law purposes;
  (7) maintenance of adequate accounting policies;
  (8) issuance of subordinated debt;

(9) overall risk management processes (for example, ensuring adequate oversight from the Board of Directors); and

(10) other operational and management standards deemed appropriate.

If a GSE failed to meet these standards, FHFA would issue them a plan to correct whatever deficiency and would be charged with either freezing an entity's total assets or requiring an increase in its capital stocks if the plan was not adhered to (in the case of a GSE being undercapitalized).

- **Housing Finance Oversight Board**: Establishes a five-member Housing Finance Oversight Board to advise the new Director on "overall strategies and policies" in carrying out the duties under the legislation. The Board would be comprised of the Director, the Secretary of the Treasury, the Secretary of Housing and Urban Development (HUD), and two other members appointed by the President with expertise in capital markets, secondary mortgage markets, mortgage financing, and the development of affordable housing.

- **Nonprofit Contributions:** Requires the GSEs to report annually the total amount of charitable contributions to nonprofit organizations made in the previous fiscal year. The report must identify the name of the nonprofit and the amount of the individual contribution if over a "designated amount" (to be set by the regulator). This information must be made publicly available.

- **Assessments:** Authorizes FHFA to collect assessments from the GSEs to provide for its costs and expenses and any enforcement proceedings against them and to punish them for being undercapitalized. These assessments are not to be construed as government funds (although the amounts collected and spent are recorded for federal budget purposes as receipts and outlays). This provision effectively frees the regulator from the appropriations process, ensuring a certain level of independence.

- **Withholding Compensation**: Authorizes the regulator to require a regulated entity to withhold compensation to its executive officer for any fraudulent act or omission, breach of trust or fiduciary duty, or violation of any law, regulation, or order.

- **Capital Requirements**: Allows the regulator to adjust the risk-based capital requirements and provide for minimum capital levels to ensure the safety and soundness of the GSEs.

- **Assets and Liabilities**: Requires FHFA to review on a periodic basis the assets and liabilities of each GSE, and if necessary, to require by order the disposal or acquiring of an asset or liability.

- **Corporate Governance**: Requires a majority of the board of directors to be "independent" as defined by the New York Stock Exchange. In addition, the bill requires the board to meet at least eight times a year and prohibits a member from voting by proxy. Compensation of board members would be limited to what is "reasonable and appropriate" and "commensurate with the duties and responsibilities of such person" and shall take into account not just earnings but also risk management and legal and regulatory compliance.

- **SEC Registration**: Requires each GSE to register at least one of its capital stock with the Securities and Exchange Commission and to comply with sections 14 (proxies) and 16 (disclosure requirements for directors, officers, and principal stockholders) of the Securities Exchange Act.

- **Guarantee Fees**: Directs GAO to study guarantee fees (the GSEs charge a fee for the risk involved with guaranteeing loans), including the factors used to determine their amount, the amount incurred by each enterprise to provide guarantees, and the total revenue earned from collecting such fees.

Subtitle B: Improvement of Mission Supervision

- **New Business Activity**: Requires the GSEs to receive approval from FHFA *before* undertaking any new programs or business activities *and grandfathers in any current ones* (some of which may be inconsistent with the GSEs charter). The regulator is required to note such an application in the Federal Register and allow for a period of public comment. Approval would then be granted on the basis of whether the new activity is: (1) consistent with the GSEs' chartering statutes taking into consideration the definition of the terms "mortgage loan origination" and "secondary mortgage loan origination," (2) consistent with the safety and soundness of the enterprise, and (3) is in the public interest. In addition, each enterprise is required to report within 180 days of the bill taking effect listing all of current activities.

- **Automated Loan Underwriting:** Prohibits the regulator from preventing a GSE from offering the "automated loan underwriting system" in existence upon enactment or other education and counseling activities as a primary market activity. This software technology uses statistical models to determine objectively in a matter of minutes whether a borrower is likely to default on a loan. Fannie Mae and Freddie Mac have pioneered such technology. (Some conservatives may view this service as a primary market activity, and by prohibiting the Director from defining it as such, the bill continues the GSEs' ability to crowd out other unsubsidized companies that wish to offer the technology but lack such a dominant market share.)

- **Lack of a "Bright Line":** Allows the regulator to define the terms "mortgage loan origination" and "secondary mortgage market" in a way that is consistent with the GSEs' chartering statutes. However, H.R. 1461 does not provide such a statutory or **"bright line" definition**, but the bill defines new business activity as one that is *materially* changed or different from any of the businesses the GSEs were engaged in upon enactment and which prior authorization has not been obtained. According to HUD Secretary Alphonso Jackson, "The 'bright line' provision…would prevent the GSEs from crossing into territory that is inconsistent from their chartered purpose."

- **Conforming Loan Limits:** Sets conforming loan limits (loans that are to be sold to Fannie Mae and Freddie Mac must "conform" with these limits) at:
  - $359,650 for a single-family residence,
  - $460,400 for a two-family residence,
  - $556,500 for a three-family residence, and
  - $691,600 for a four-family residence

  H.R. 1461 requires these limits to be increased or decreased each year depending on a new housing index the FHFA is directed to establish surveying the housing market.

In addition, the bill allows for the GSEs to further increase the loan limit in **"high cost areas"** where the median price for such size residences exceeds the conforming loan limit. The adjustment would be up to the lesser of 150% of the loan limit (in 2005, $540,000 is 150% of the single-family conforming loan limit) or the area median home price and would apply only to mortgages that are the basis for securities sold by the enterprises. H.R. 1461 then requires the FHFA to study whether restricting this increase in the conforming loan limits in high cost areas to such mortgages "will result in an increase in the cost to borrowers." If so, the regulator is permitted to terminate the restriction. (Some conservatives may be concerned that this provision will lead to an overly broad definition of "high-cost area," lessening the cost (via federal subsidies) of housing for consumers who are not necessarily low or middle income and crowding out private competitors.)

- **Affordable Housing Goals:** Requires the FHFA to set annual single-family and multi-family goals for the GSEs to purchase mortgages benefiting low-income families and families living in low-income areas. These targets would be a percentage of the three-year rolling average of publicly available data as required under the Home Mortgage Disclosure Act of 1973 and could be increased or reduced at the discretion of the Director. In addition, H.R. 1461 adds a duty for the GSEs to serve "underserved markets," including in rural areas, by developing certain loan products and flexible underwriting guidelines.

  If a GSE fails (or there is a substantial probability that it will fail) to comply with the affordable housing goals, the regulator is authorized to inform the enterprise, the reasons for such a determination, and the data on which it is based. In addition, the regulator *may* require that the enterprise submit a housing plan for it to meet its housing goals. If the GSE refuses to submit such a plan, submits an unacceptable plan, or fails to comply with the plan, the regulator may issue a cease and desist order or impose civil monetary penalties.

  Affordable housing goals are already a part of current law to ensure that the GSEs, which benefit from substantial federal subsidies, are not driven solely by profit but also a commitment to expand housing to low-income families in low-income areas. However, the GSEs have typically not met their goals, and the current regulatory structure lacked the power to force compliance.

- **Affordable Housing Fund**: Requires the GSEs to establish and manage an affordable housing fund equal to 5% (3.5% in the first year) of their after-tax income for the preceding year. The GSEs would distribute the funds for downpayment assistance, closing cost assistance, interest-rate buy downs, and grants to third-party entities, including state housing finance agencies, *non-profits* with the principal purpose of developing and managing affordable housing, and community development institutions. According to the Committee Report, these grants would be used for: "(1) development, preservation, rehabilitation, or purchase of affordable housing that meets underserved needs for affordable housing; and (2) community or economic development activities in economically underserved areas." The bill limits the amount of leveraged grants to 12.5% of the fund. In addition, H.R. 1461 creates an Affordable Housing Board composed of between 7-11 persons, including the Secretaries of HUD, Agriculture, and Treasury, the Director, and 2 persons from both for-profits and non-profits with expertise in promoting affordable housing.

Many members of the RSC raised substantial concerns regarding this fund and sent a letter to House Leadership (please visit: http://johnshadegg.house.gov/rsc/GSE%20slush%20fund.pdf) requesting the fund be dropped before House floor consideration. In particular, conservatives argued that the fund amounts to a 3.5-5% tax on two publicly traded companies, and since the GSEs constitute a duopoly, they have a heightened ability to pass this "contribution" on to consumers – thus making housing less affordable rather than more. Furthermore, conservatives were concerned that funds intended for affordable housing would instead be used to subsidize the political activity of left-leaning, third-party entities. For example, the GSEs have contributed to such "housing" groups as:

- ACORN (led voter registration efforts against Republicans, with allegations of voter fraud, in Florida, Ohio, and North Carolina)
- National Council of La Raza
- Housing Works (led a demonstration against Senator Rick Santorum for his anti-needle exchange and pro-abstinence voting record)

Note: As a result of an agreement between the RSC and the Financial Services Committee, the manager's amendment is expected to address *some* of the concerns with regard to the affordable housing fund. Importantly, the manager's amendment will ensure that none of the funds can be distributed to a third-party entity that engages in federal election activity (as defined under current campaign finance law) or lobbying. See the description of the manager's amendment below.

<u>Subtitle C: Prompt Corrective Action</u>

- **Capital Classifications**: Requires the regulator to classify the capital levels of the GSEs and the Federal Home Loan Banks as either adequately capitalized, undercapitalized, significantly undercapitalized, or critically undercapitalized. The Director could reclassify a GSE for deficient capitalization if it is "engaging in conduct that could result in a rapid depletion of core or total capital," if after notice and a hearing, it is determined the GSE is "engaging in an unsafe or unsound practice" or in "an unsafe and unsound condition." In addition, H.R. 1461 prohibits a GSE from making a capital distribution that would cause it to be undercapitalized.

  Some conservatives may be concerned that H.R. 1461 does not improve substantially on the powers of the current regulator. According to a study by American Enterprise Institute (AEI), "the regulator will lack the authority and leverage against a GSE to increase capital temporarily to address a problem such as the recent accounting and internal control failures…unless it can make the case that these tie directly to safety and soundness." Source: http://www.aei.org/publications/pubID.22705/pub_detail.asp

- **Capital Restoration**: Requires the regulator to closely monitor the condition of undercapitalized enterprises and whether they are complying with a capital restoration plan If a GSE lacked such sufficient capital levels, its total assets would be frozen at the level of the preceding calendar quarter unless the regulator accepted its capital restoration plan (and an increase in assets is consistent with that plan) or the ratio of total capital to assets would enable it to become adequately capitalized in a reasonable amount of time. In addition, H.R. 1461 prohibits an undercapitalized GSE from acquiring any new entities or engaging in any new business activity unless it is similarly consistent with an approved capital restoration plan.

- **Significantly Undercapitalized Measures**: Allows the regulator to take action against a significantly undercapitalized GSE to improve its management by: (1) ordering the election of a new board of directors, (2) dismissing any board member or executive officer who held office for more than 180 days prior to the entity becoming undercapitalized, and (3) employing qualified executives. In addition, H.R. 1461 prohibits a significantly undercapitalized entity from paying out a bonus to any executive if in the last year the entity has became significantly undercapitalized.

- **Appointment of a Conservator**: Allows (but does not require) the regulator to appoint FHFA as conservator to manage the financial affairs of a critically undercapitalized GSE if:

    - the entity's assets are less than its obligation to its creditors;
    - there has been substantial dissipation of assets resulting from either a violation of the law or an unsafe and unsound business practice;
    - the entity willfully violated a cease and desist order or concealed its records from the regulator;
    - the entity sustained a substantial loss to its capital and there is no "reasonable prospect" of becoming adequately capitalized; or
    - the entity either fails to submit or to implement a capital restoration plan.

    The conservator would have the power to restore the entity to a sound and solvent condition, including through liquidating the entity (with due regard to the housing finance market) and winding up its affairs. However, according to the Committee Report, "mortgages, or interest in a pool of mortgages, held in trust, custodial, or agency capacity by a regulated entity shall not be available to satisfy the claims of creditors generally. Such mortgages or interest in a pool of mortgages shall be held by the conservator or receiver for the beneficial owners of such mortgages."

<u>Subtitle D: Enforcement Actions</u>

- **Cease and Desist Orders**: Allows the regulator to issue cease and desist orders to a GSE that is about to engage in an unsafe or unsound business practice or has violated a law or regulation. Unsound and unsound business practice is defined as a less-than-satisfactory rating for asset quality, management, earnings, or liquidity. Temporary cease and desist orders may be issued if such activities or violations is likely to cause insolvency or a significant dissipation of assets. If a cease and desist order is not obeyed, the regulator may seek an injunction to enforce the order in federal district court.

- **Enforcement and Jurisdiction:** Authorizes the regulator or the Attorney General upon request to seek enforcement of orders in federal district court.

- **Civil Penalties:** Establishes three tiers of civil penalties: (1) $10,000 for each day for violating orders and regulations; (2) $50,000 for each day for any violation that "recklessly engages in an unsafe or unsound practice," breaches a fiduciary duty, and is part of a pattern of misconduct; and (3) a maximum $2 million for each day when such misconduct is done knowingly.

- **Management Removal:** Authorizes the removal of any official from his post (with fair notice and hearing) who violates an order, engages in unsafe or unsound activity, breaches a fiduciary duty, *and* such action involves personal dishonesty or a willful disregard for the safety and soundness of the entity. Anyone who knowingly participates in the business of the enterprises after being suspended or removed shall be liable for a fine of up $1 million or five years of imprisonment.

Subtitle E: General Provisions

- **Presidentially-Appointed Board Members:** Eliminates the current requirement that five of the GSEs' Board of Directors be appointed by the President and reduces the size of the board from 18 to between 7 and 15.

- **Portfolio Operations Report**: Requires the FHFA to report to Congress with: (1) a description of the GSEs portfolio holdings, including mortgages, mortgage-backed securities, non-mortgages and any other assets; (2) a description of the risk involved with such holdings (including the use of derivatives to hedge against such risk); (3) an analysis of whether such holdings are safe and sound and consistent with the mission of the GSEs, and (4) an assessment of the risk such portfolios pose for the housing and capital markets as a whole.

- **Alternative Secondary Market System Study**: Requires FHFA to study alternatives to the current secondary market system if the GSEs were privatized and how it would impact taxpayers.

- **Effective Date**: The provisions establishing the new regulator take effect one year after enactment. Please see below for possible conservative concerns with this one year delay.

Title II: Federal Home Loan Banks

- **Boards of Directors**: Reduces the number of directors for each Federal Home Loan Bank (FHLB) from 14 to 13 – none of whom will be appointed – and increases the term of service from three to four years. In addition, H.R. 1461 repeals the cap on director compensation and allows pay to be based on what is reasonable and appropriate.

- **Joint Activities:** Permits two or more FHLBs to establish a joint office for the purpose of performing common or collective functions.

- **Voluntary Mergers:** Permits the FHLBs to merge with each other upon the approval of their own Boards of Director and the new regulator.

- **SEC Disclosure Requirements:** Exempts the FHLBs from certain SEC disclosure and reporting requirements with respect to their ownership of capital stock and transactions in the ordinary course of business.

- **Community Financial Institution Members:** Allows insured depository institutions with less than $1 billion in total assets (increasing the threshold from $500 million) to receive advances from the FHLBs for lending. In addition, the bill adds community development lending to the list of allowable uses of such advances.

- **Affordable Housing Program Study:** Requires GAO to study the extent to which the FHLBs' current affordable housing programs are being used to assist long-term care facilities for low and moderate income individuals.

Title III: Transfer of Functions, Personnel, and Property of OFHEO and Federal Finance Board

- **Abolishment of OFHEO:** Abolishes OFHEO after one year when most of the bill's provision takes effect and establishes the transfer of functions to FHFA. However, during the one year period beginning on the date of enactment, the OFHEO director is instructed to manage the office "solely for the purpose of winding up the affairs." Some conservatives may be concerned that this "**one-year gap** means that, for a full year, the GSEs will operate without examination, regulation of safety and soundness, regulation of their new activities, or regulation of their affordable housing activities…*They will be able to expand into new activities*" (emphasis added).
  Source: http://www.aei.org/publications/pubID.22705/pub_detail.asp

- **Employee Rights:** Guarantees that each OFHEO employee is transferred to FHFA for employment with the same status, tenure, grade, and pay as held immediately prior to the transfer and will retain their benefits for at least one year.

- **Abolishment of the Federal Housing Finance Board:** Abolishes the Federal Housing Finance Board after one year when most of the bill's provisions take effect. In addition, bill extends the same guarantee to the Board's employees of a guaranteed position and continued pay and benefits.

Amendments Made in Order under the Rule (H. Res. 509):
All amendments are debatable for ten minutes, except for the manager's amendment which will be debated for twenty minutes. Summaries are based on RSC staff's review of actual amendment text.

Oxley (R-OH). Manager's Amendment. Replaces the entire section establishing the affordable housing fund with new language. The GSEs would establish and manage an affordable housing fund equal to 3.5% (in the first two years) and 5% (for the subsequent three years) of their after-tax income of the preceding year. The bill allows for the temporary suspension the GSEs' contributions if the regulator finds that it would lead to the financial instability of the enterprise or lead it to be undercapitalized. The fund would be sunset after five years of GSE contributions. 25% of the funds would be devoted to the U.S. Treasury to help pay off RefCorp (S&L) bonds, and the rest would flow to affordable housing.

The GSEs would distribute the funds to entities (for-profits, non-profits, faith-based organizations, and state or local government agencies) with a demonstrated capacity in affordable housing development. The funds would be used for downpayment assistance, closing cost assistance, interest-rate buy downs, the production or rehabilitation of rental housing for low-income families. The funds could not be used for political activity, advocacy, lobbying, counseling services, travel expenses, or the preparation of tax returns. In addition, during the first two years of the fund, priority would be given to applications seeking to develop affordable housing in disaster areas from Hurricanes Katrina and Rita.

The manager's amendment includes the language negotiated with members of the RSC to ensure that any non-profits *or their affiliates* which <u>*chooses to participate in the fund*</u> must not be engaged in federal election activity and electioneering communication (as defined under campaign finance law) or lobby (as defined by the Internal Revenue Code, including the de minimus exception under current law). An affiliate is defined as an entity who either controls or is controlled by another entity, and "control" is judged to be present when there is: (1) overlapping board members, executives, or staff; (2) shared resources such as office space, staff members, supplies, marketing materials, and public forms of communication (including the Internet); (3) common funding where one entity either receives or contributes more than 20% of its funding from another entity; or (4) other factors that the regulator may set forth in regulation. This language was added at the behest of conservative members concerned that funds intended for affordable housing would end up subsidizing political activity.

The manager's amendment also strikes the effective date so that the new regulator takes effect only six months after enactment instead of one year (see above).

Carson (D-IN). Allows the regulator to consider "loans secured by both real and personal property" (or secured by manufactured housing) when determining whether a GSE has complied with its affordable housing goals. Manufactured homes are built off-site and transported to the building site where they are installed.

Davis (D-AL). Strikes the definition of "rural area" and replaces it with language aligning it with the definition under current housing law (42 U.S.C 1490) instead of using the definition used by Office of Management and Budget. In addition, the amendment retains "micropolitan areas and tribal trust lands" as part of the definition. A micropolitan area (formerly known as a non-metropolitan area) is a statistical area containing at least one urban cluster of at least 10,000 but no more 50,000 people – usually a large rural county with one small urban or economic hub.

Leach (R-IA). Allows for the establishment of stronger minimum capital levels by allowing the regulator to take into consideration "the particular circumstances of the particular regulated entity, which may include any prudential standards necessary *to ensure long-term institutional viability and competitive equity in the market*" in addition to ensuring that the GSEs and the FHLBs operate in a safe and sound manner.

Royce (R-CA). Allows the regulator *to dispose* or acquire an asset or liability (after conducting a periodic assessment of the overall assets and liabilities of each GSE) if it would "mitigate systemic risk to the housing or capital markets or the financial system." The current provision limits this ability to a determination of whether such action contributes to the safe and sound operation of the GSEs.

According to information from the amendment sponsor:

> The huge concentration of mortgage assets at the two enterprises coupled with the dangers associated with interest rate risk has caused many experts to express concern about the systemic risk Fannie Mae and Freddie Mac pose to the housing market, the capital markets, and the global financial system. The

> Federal Reserve Board and the Treasury Department have proposed a solution to this problem whereby the GSEs' on-balance sheet assets would be severely limited. My amendment does not require the regulator to reduce the GSEs' mortgage assets; however, the amendment would authorize the regulator to do so if the director deemed the GSEs' mortgage assets to be a systemic risk.

Paul (R-TX). Eliminates the ability of the GSEs and the FHLBs to borrow at below market rates from the Treasury. Currently, these regulated entities have a line of credit of up to $2.25 billion to which their private competitors do not have access.

Garrett (R-NJ). Strikes the language in the bill pertaining to conforming loan limits, including the provision that allows them to be raised in "high-cost areas" where the median price for such size residences exceeds the conforming loan limit.

Sanchez, Loretta (D-CA). Requires the regulator in compiling the annual housing report under Section 124 to examine the use of alternative credit scoring. Alternative credit scoring is when lenders focus less on a prospective borrower's credit history (especially when they do not have a credit history) and more on other factors, such as a regular income, consistently paying bills on time, strong investing habits, etc.

Kanjorski (D-PA). Maintains current law with respect to the requirement that five of the GSEs' Board of Directors be appointed by the President but allows for H.R 1461's reduction in the overall size of the board from 18 to between 7 and 15. The amendment also modifies the board composition of the FHLBs by: requiring that two-thirds of the directors of each bank (instead of one-third) be independent, allowing the regulator to recommend individuals, requiring that community and economic development be an area of expertise for public interest directors, and allowing appointed independent directors to serve until their successor has been appointed (even if their term has expired).

Committee Action: On April 5, 2005, H.R. 1461 was referred to the House Financial Services Committee, which reported the bill on July 14th by a vote of 65 to 5 for consideration by the full House of Representatives.

Cost to Taxpayers: According to the House Budget Committee:

> FHFA is authorized to collect fees from the GSEs and to spend the fees to pay for its operating costs. The amounts collected and spent are recorded in the Federal budget as revenue and outlays, respectively. Also, the collections and spending of the affordable housing funds are recorded in the Federal budget as revenue and outlays….As reported, the bill provides substantial increases in direct spending. Because the Financial Services Committee does not have any remaining allocation of direct spending, the reported measure violates section 302 of the Congressional Budget Act. The budgetary impact of the bill is significant, *but the reason for the Budget Act violation is somewhat technical*: specifically, to avoid the violation, the bill must offset its higher spending with higher revenue in *each of the 5 years* covered by the budget resolution. The reported bill falls short of this requirement in several years. *The proposed manager's amendment modifies the bill such that its revenue increases do match or exceed its spending increases in each year*. Section 302(g) of the Budget Act provides that, under these conditions, the above-cited points of order will not lie against the bill. (emphasis added)

In short, H.R. 1461 violates the Budget Act because the fees it authorizes to be collected do not offset the regulator s operating costs *in each year* of the budget resolution. However, if passed, the manager s amendment would correct this budget imbalance and bring the bill into compliance.

<u>Does the Bill Expand the Size and Scope of the Federal Government?</u>: Yes, the bill includes a new tax on the secondary mortgage market (stemming from the GSEs contributions to the affordable housing fund) and increases the conforming loan limits in high-cost areas which expands the reach of federal subsidies further into the private sector.

<u>Does the Bill Contain Any New State-Government, Local-Government, or Private-Sector Mandates</u>?: Yes, the bill imposes several private-sector mandates on Fannie Mae, Freddie Mac, and the FHLBs.

<u>Constitutional Authority</u>: The Financial Services Committee, in House Report 109-171, cites constitutional authority in Article I, Section 8, Clause 1 (relating to the general welfare of the United States) and Clause 3 (the congressional power to regulate commerce among the states).

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